SUMMARY OF INITIAL IRS GUIDANCE ON NONQUALIFIED DEFERRED COMPENSATION PLANS*

FEATURE	HIGHLIGHTS OF NOTICE 2005-1	COMMENTS
Overview/Scope of Notice 2005-1 Guidance	This guidance is first in an expected series of regulatory pronouncements on the new deferred compensation rule of Code section 409A. The new guidance is limited in scope, and takes the form of 38 questions and answers, on the following topics: • definitions and coverage; • stock options and stock appreciation rights; • change in control events; • acceleration of payments; • effective dates and transition relief; and • application of information reporting and wage withholding requirements. In addition, the Notice seeks comments on various other aspects of section 409A that Treasury and IRS intend to address in future guidance.	The guidance generally provides welcome relief in narrowing the scope of section 409A and providing, for the most part, liberal transition relief. It does not, however, address a number of important issues, which will be relevant to the operation of deferred compensation plans in 2005. As discussed below, while Notice 2005-1 permits employers to delay the adoption of amendments to their deferred compensation plans until the end of 2005, the plans will nonetheless need to be operated in 2005 in good-faith compliance with the new rules of Code section 409A, with respect to deferrals that are not grandfathered. This means, for example, that employers will need to address issues that are not covered in the guidance, such as when a participant has separated from service, how the rules of Code section 416(i) will be applied in determining who is a key employee of a publicly held company, etc.
Definitions and Coverage **Definitions and Coverage (cont'd)**	Deferred compensation plan. A deferred compensation plan is any plan that provides for the deferral of compensation. Q&A 3. In general, the requirements of section 409A are applied as if a separate plan is maintained for each participant, treating all compensation deferred with respect to such participant under all account balance plans, all nonaccount balance plans, and all other plans as deferred under single plans. Q&A 9. For these purposes, "account balance plan" and "nonaccount balance plan" have the meanings given these terms under the section 3121(v)(2) regulations.	The Notice's definition of deferred compensation plans, together with its special carve-out for short-term deferrals, appears to create an exception for multi-year compensation arrangements that pay out immediately upon vesting. The resulting exception should exempt from section 409A long-term incentive or bonus plans that pay out immediately upon vesting, and also severance plans that pay a lump sum benefit upon involuntary dismissal, where the participant has no legally binding right in advance of payment. Further deferral of such payments, though, would be subject to the rules of section 409A.

* This chart describes the provisions of Notice 2005-1, which Treasury and the IRS issued on December 20, 2004 , and which represents the first round of regulatory guidance on the application of the nonqualified deferred compensation legislation in section 409A of the Internal Revenue Code ("Code") that was enacted as part of the American Jobs Creation Act of 2004.

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Definitions and Coverage (cont'd)	What is deferred compensation? The Notice narrows the scope of section 409A by adopting a definition of deferred compensation that is keyed to the deferral of payment to a year after the year in which the taxpayer acquires a vested right to the payment. Thus, a plan provides for the deferral of compensation if the participant has a legally binding right to compensation that has not been actually or constructively received and included in gross income and is payable in a subsequent taxable year. *Caution:* Treasury has indicated that it is considering a more restrictive rule for arrangements involving payments in later taxable years that are structured to coincide with a lapse in a substantial risk of forfeiture. Comments are requested on whether additional guidance is needed to prevent arrangements from being designed to evade the application of section 409A. Legally binding right. To apply the definition of deferred compensation, it becomes important to determine when a participant is viewed as having a legally binding right to compensation for these purposes. In this connection, the Notice indicates in Q&A 4(a) – • such a right generally does not exist if compensation may be unilaterally reduced or eliminated after the performance of services (other than by operation of objective terms of the plan); • on the other hand, depending on the facts, such a right may exist if the reduction/elimination of the right will only occur on a condition that is unlikely to occur or if the discretion to reduce or eliminate the compensation is unlikely to be exercised; and • such a right will be treated as being legally binding where it is reduced pursuant to the operation of the objective terms of the plan, such as – o an objective provision in the plan creating a substantial risk of forfeiture; o an offset feature in the plan that reduces benefits by reference to benefits in a qualified plan; o a provision that reduces benefits by reference to actual or hypothetical investment losses; and o a provision that bases benefits on final pay (where final pay may go down). Payable in a subsequent taxable year. The Notice exempts certain short-term deferrals from section 409A, including payroll	By contrast, it appears that multi-year compensation arrangements that provide for partial vesting over the performance/service period, instead of cliff vesting, with payment delayed until the end of the period, would be subject to section 409A, and that vesting under multi-year arrangements must effectively be cliff vesting, or must be accompanied by an immediate distribution of the incremental amount of the vested compensation, to avoid coming within the scope of section 409A. In addition, while the Notice makes it clear that acceleration of vesting is not prohibited under the anti-acceleration rules, acceleration of vesting may have an adverse impact on a multi-year arrangement that is otherwise exempt from the deferred compensation rules, unless the acceleration of vesting is accompanied by immediate payout of compensation. So, if a multi-year compensation arrangement provides for cliff vesting at the end of the performance/service period, but also permits acceleration of the vesting (but not payout) upon the occurrence of certain events, such as change in control, etc., the plan may fail to meet the requirements of the exception, and be subject to the deferred compensation rules, either initially or upon the acceleration of the vesting. Based on the definition of "legally binding," it appears that a participant is likely to be viewed as having a legal right to compensation even if the participant will forfeit the compensation by engaging in competition or an illegal act if those acts are not likely to occur. The interaction under the Notice between the rules for situations

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	payments that overlap a taxable year, and also, at least until additional guidance is issued, a plan where payment is required no later than 2-1/2 months after the end of the participant's taxable year in which the amount vests (or, if later, 2-1/2 months after the end of the taxable year of the service recipient in which the amount vests). Q&A 4(b) and (c). Exception for welfare and other plans. The Notice clarifies that the exception for disability pay and death benefit plans should be read narrowly, and incorporates for these purposes the definition of such terms under the section 3121(v)(2) regulations which focuses on the amount of benefit that exceeds the amount of lifetime benefits under a plan . Q&A 3(c). State and local entities and tax-exempt entities can, for the time being, rely on the definitions of bona-fide vacation leave, sick leave, compensatory time, disability pay, and death benefit plans under section 457(f) for purposes of applying section 409A. Q&A 6.	giving rise to "legally binding rights" and situations giving rise to a "substantial risk of forfeiture" is not always clear. For example, it appears that a legally binding right may exist even if this right is subject to objective plan provisions that can cause reduction or elimination of compensation, and thus are tantamount to a substantial risk of forfeiture. By itself, this might lead one to conclude that the arrangement was subject to section 409A, but if the arrangement calls for payment relatively concurrent with vesting, the Notice's exception for payments paid no later than 2-1/2 months after the taxable year in which the compensation vests should keep the arrangement outside the scope of section 409A.
Definitions and Coverage (cont'd)	Who is a covered service provider? Generally, section 409A covers arrangements with non-employees, including independent contractors and partners in a partnership. Q&A 3(a). The Notice provides certain limited relief from section 409A for certain partnership arrangements. Q&A 7. A service provider may include a personal service corporation, but the term will not include an arrangement between accrual-method taxpayers or between a service provider and a service recipient, if the service provider is not an employee or director, and provides services to two or more unrelated, service recipients. Q&A 8. General rule of income inclusion for deferred compensation. Unless the requirements of section 409A are satisfied by a deferred compensation plan, both in form and operation, deferrals under the plan are currently includable the affected participant's gross income to the extent they are not subject to a substantial risk of forfeiture (or have not been previously included in income). Q&A 2. Substantial risk of forfeiture. Compensation is subject to a substantial risk of forfeiture if entitlement is "conditioned on the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial." Such a condition must relate to the participant's performance or to the employer's business activities or organizational goals. An addition or extension of a substantial risk of forfeiture after the	The Notice effectively exempts from the scope of section 409A businesses that provide services to two or more unrelated service recipients with respect to their customer receipts (but not with respect to arrangements for their own employees or independent contractors). The Notice incorporates the broader definition of substantial risk of forfeiture under the section 83 regulations, which include not only the performance of services, but also conditions that are related to the purpose of the compensation. The Notice effectively prevents delaying taxation under section 409A by extending the forfeiture period through the use of a rolling

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	beginning of the service period is not recognized for purposes of section 409A. In addition, a substantial risk of forfeiture will not be considered to exist merely because of a non-compete requirement. Q&A 10.	risk of forfeiture.
Equity-based Compensation	Notice 2005-1 excepts from the scope of section 409A certain types of equity compensation. Stock options. Under the Notice, incentive stock options ("ISOs") and options granted employee stock purchase plans qualified under section 423 are not considered deferred compensation under the new rules. Other stock options are also not considered deferred compensation but only if (1) the exercise price is not less than the fair market value of the stock on the date the option is granted, (2) the receipt, transfer or exercise of the option is subject to tax under section 83, and (3) the option does not include any additional deferral features. For purposes of determining the fair market value of the stock at the date of grant, any reasonable valuation method may be used. Substitution of nonqualified options in corporate transactions where the requirements of the ISO modification rules would be met will not be treated as the grant of a new option for these purposes. Q&A 4(d)(ii) and (iii).	*Caution*: It is important to keep in mind that stock options and SAR arrangements not falling with the specific exceptions in the Notice will be subject to section 409A, and unless structured to have fixed payment dates that comply with the distribution requirements of section 409A, will subject the holder to adverse tax consequences. Note that the exception for nonqualified stock options requires that the option be taxed under section 83. The exception thus does not appear to cover payments in cash to settle stock options, except possibly to the extent the arrangement might be treated as subject to the special transition rule for SARs described below. In this connection, it is not clear what the result is under the Notice if an otherwise exempt stock option is cashed out in connection with a corporate transaction. Also, the guidance does not address the payment of dividend equivalents in connection with stock options or SARs, and whether their inclusion will adversely affect the exempt status of
Equity-based Compensation (cont'd)	SARs. The Notice excludes stock appreciation rights ("SARs") from the definition of deferred compensation if (1) the SAR exercise price is not less than the fair market value of the stock on the date the right is granted, (2) the stock subject to the right is traded on an established securities market, (3) only such traded stock may be delivered in settlement of the right upon exercise, and (4) the right does not include any additional deferral features. Notwithstanding the foregoing, until further guidance is issued, payments made upon the exercise of a SAR (or payment on cancellation of such right) that was granted pursuant to a program in effect on or before October 3, 2004 are not deferred compensation regardless of whether the stock is traded on an established securities market or the payment is in cash or stock. Q&A 4(d)(iv). Restricted stock. Restricted stock is carved out of the definition of deferred compensation. However, a promise to deliver restricted property in the future may fall within the scope of section 409A if the service provider had a legally binding right to receive such property. Q&A 4(e).	a stock option or SAR. Perhaps dividend equivalent payments can be structured as separate deferred compensation plans so that they do not taint the stock option plan or SARs, and so that they meet the distribution requirements of section 409A. Pending further clarification, employers should be cautious in offering non-grandfathered dividend equivalent payments. The Notice permits any reasonable method for determining the fair market value of the stock on the date of grant to be used in determining the exercise price. It is not clear the extent to which rolling averages of trading prices will be permitted for these purposes, but in the absence of further guidance, employers should be cautious about using such pricing methods for their options or SARs. The exception for SARs generally requires that the SAR be settled in traded stock of the service recipient on exercise of the SAR and cautions that the presence of a right to settle the SAR in cash or an arrangement whereby the stock will be bought back by the employer could be problematic. The Notice provides transition relief for SARs granted under

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		programs in effect on or before October 3, 2004. It appears that such relief extends not only to SARs that were outstanding on October 3, 2004 but also SARs that are granted in the future under the program. Employers relying on such relief will want to be careful about modifying the program. There is no exception under the Notice for nonqualified stock options or SARs that are granted with an exercise price less than the stock's FMV at the date of grant. Unless the arrangements are grandfathered under the effective date provisions (see discussion below), they will need to be modified to conform to section 409A.
Change in Control Events	Section 409A provides that a plan may permit distribution upon a change in control to the extent permitted by the Treasury. The Notice elaborates that a plan may permit distributions upon any of the following "change in control events," each of which must be objectively determinable (and not involve the exercise of discretionary authority):	Employers will need to consider carefully provisions in their plans that call for distributions on change of control. To avoid running afoul of section 409A, these provisions will have to conform to the definition in the Notice, and generally to preclude discretion in the determining a change in control.
Change in Control Events (cont'd)	• Change in the ownership of the corporation: the acquisition, by one person or a group, of stock of the corporation that causes such person or group to own more than 50 percent of the total fair market value or total voting power of the stock of such corporation. Q&A 12. • Change in the effective control of the corporation: either (1) the acquisition, by one person or a group, of ownership of 35 percent or more of the total voting power of the stock of the corporation, or (2) the replacement of a majority of the members of the board of directors with directors whose appointment or election is not endorsed by the existing board. Q&A 13. • Change in the ownership of a substantial portion of the assets of the corporation: the acquisition of assets from the corporation that have a total gross fair market value of 40 percent or more of the total gross fair market value of all of the assets of the corporation prior to the acquisition. Q&A 14. Plan sponsors may have discretion to terminate a plan and make distributions within 12 months of a change in control event, but the plan must provide for this discretion. Q&A 11. In each case, the change in control event must relate to the corporation for whom the participant is providing services, or to the corporation that is liable for the payment of the deferred compensation (or to any corporation in an upward chain from either of these corporations). Q&A 11.	Because vesting without acceleration of payments is generally not prohibited under section 409A (see discussion below), employers that do not wish to restrict themselves to the Notice's definition of change in control may wish to consider providing for vesting and transfer of amounts to a rabbi trust, in lieu of payment, on change in control. However, change in control distributions (in accordance with the Notice's definition) may be necessary to deal with instances in which the employer disappears in a corporate transaction, and the surviving corporation does not continue the plan. The special one-year window provided in the Notice for discretionary distributions on plan termination may provide sufficient flexibility for this purpose. In this connection, given the general lack of flexibility in the distribution rules under section 409A, it seems that employers may want to consider adding a discretionary change in control/plan termination distribution provision to their plans, regardless of their views on change in control distributions. The application of the discretionary change in control/plan termination provision where some, but not all, of the participants are affected by a change in control, e.g., a sale of subsidiary employing some of the participants, is not clear. Given the definition of "plan" in the Notice, it may be that the discretionary change in control/plan termination provision may be applied to

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		terminate the portion of the plan covering the affected participants, but further clarification of this point by Treasury would be helpful.
Acceleration of Payments **Acceleration of Payments (cont'd)**	The new rules restrict the acceleration of payments under a deferred compensation plan, but the Notice makes clear in Q&A 15 that acceleration of vesting is not considered an impermissible "acceleration of the time or schedule of any payment under the plan" under section 409A. Furthermore, acceleration is permissible in the following circumstances: • A plan may permit acceleration as necessary to respond to a domestic relations order; • A plan may permit acceleration as necessary to comply with a certificate of divestiture due to conflicts of interest; • A section 457 plan may permit acceleration in order to pay taxes due upon vesting; • A plan may permit acceleration of a de minimis amount (under $10,000) upon the participation's separation from service; • A plan may also be amended with regard to future accruals to provide for acceleration and cash-out, so that if the participant's interest under the plan at the time of payment is less than a specified amount, the participant's entire interest will be paid as a lump sum; and • A plan may permit acceleration to pay employment taxes on compensation deferred under the plan.	The guidance permits acceleration only in certain specified instances. It is important to note that there is no general exception for plan termination (other than the special rule with regard to plan termination on a change in control (see discussion above) or in 2005 (see discussion below). While the guidance appears to permit lump sum cash-outs for amounts in excess of $10,000, the guidance requires that the cash-out apply only after amendment of the plan with regard to future accruals. Since this rule contemplates that the participant's <u>entire</u> interest will be paid as a lump sum, it is not clear how this cash-out right (cash-outs in excess of $10,000) can be added to an existing plan. It appears that for payment to be permissibly made in these circumstances, the payment must be required under the terms of the plan, and may not be left to the discretion of the employer or plan administrator.
Effective Date and Transition Relief	Section 409A is generally effective with respects to (1) amounts deferred after December 31, 2004, and (2) amounts deferred prior to January 1, 2005, if the plan under which the deferral is made is materially modified after October 3, 2004. The Notice makes it clear that the new rules apply to earnings on deferrals only to the extent they apply to the underlying deferrals. Q&A 16(a). <u>Eligibility for grandfather treatment</u>. An amount is considered deferred prior to January 1, 2005 if (1) the participant has a legally binding right to be paid the amount and (2) the right to the amount is earned and vested, *i.e.*, it is not subject to a substantial risk of forfeiture or a requirement to perform further services. Q&A 16(b). <u>Calculation of grandfathered deferrals</u>. For purposes of the effective date, the amount of compensation deferred prior to January 1, 2005 is determined separately for nonaccount balance plans, account balance plans, and equity-based compensation plans. Q&A 17.	While the Notice generally liberalizes the rules of section 409A in a number of respects, it takes a hard line on what amounts will be grandfathered and thus exempt from the section 409A restrictions. Amounts attributable to periods prior to 2005 will be grandfathered only if the participant has a legally binding right to the amount and the amount is not subject to a substantial risk of forfeiture. Accordingly, deferrals with respect to 2004 bonuses generally will not be treated as grandfathered if the amount is subject to reduction (e.g., negative discretion under section 162(m)) or if the participant must otherwise be employed on the payment date in 2005 to earn the bonus. It appears, though, that the deferral of a bonus that is vested and determinable as of December 31, 2004, but not actually determined until a later date, would be grandfathered. The Notice also limits the scope of the grandfather exception with regard to amounts deferred under nonaccount balance plans or defined benefit type arrangements by restricting the grandfather to

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Effective Date and Transition Relief (cont'd)	For nonaccount balance plans (such as defined benefit plans), the amount deferred prior to January 1, 2005 is the present value on December 31, 2004 of the amount to which the participant would be entitled if he or she terminated on that date. For account balance plans, the amount deferred prior to January 1, 2005 is the participant's earned and vested account balance as of December 31, 2004. For equity-based compensation plans, the account balance is deemed to be the amount of the payment available to the participant on December 31, 2004 (or that would be available if the right were immediately exercisable), but the payment available excludes any exercise price payable by the participant. Q&A 17. Generally earnings on these amounts are also excluded, but in computing the earnings on the nonaccount balance plan, the Notice requires that the earnings be limited to increases due solely to passage of time, using the same interest rate used to determine the amounts deferred under the plan before January 1, 2005. Q&A 17. <u>What is a material modification</u>? In order to maintain the grandfather relief for amounts deferred prior to January 1, 2005, there can be no material modification of the plan after October 3, 2004. A material modification is an enhancement of a benefit or right, or an addition of a new benefit or right, whether through the exercise of the employer's discretion or by an amendment of the plan. A material modification includes accelerating the vesting of a benefit to a date on or before December 31, 2004, but does not include a change involving market-available investment choices or the exercise of distribution discretion by the employer under the terms of the plan as in effect on October 3, 2004. Moreover, an adoption of a new arrangement or grant of an additional benefit may not constitute a material modification if the action is "consistent with the service recipient's historical compensation practices." Finally, the Notice allows plan sponsors to treat grants of additional benefits that would otherwise be viewed as a material medication of the plan as being separately subject to section 409A, without jeopardizing the grandfather status of the plan. Q&A 18(a) and (b). Amendment of a plan to stop future deferrals is not a material modification. Moreover, termination of a plan and distribution to	the present value of the benefit that the participant would receive if the participant has terminated on December 31, 2004. The Notice indicates that this methodology for computing the grandfathered amount has the effect of subjecting to the new rules additional accruals or benefit increases that are attributable to the value of early retirement subsidies that the participant subsequently vests in or to compensation upticks under a final pay formula. Correct calculation of the grandfathered amount will be critical to preserving the grandfather since overages in the form of additional accruals are subject to the section 409A taxation rules. Inadvertent application of the grandfather rules to new accruals will result in adverse tax consequences to the participant. As noted, earnings on grandfathered amounts are protected, and it appears that the methodology prescribed by the Notice with regard to calculation of earnings on grandfathered amounts under a nonaccount balance plan will result in effectively protecting the annuity equivalent of the grandfathered present value amount. The Notice generally appears to track the legislative history of section 409A with regard to the definition of material modification, but it does liberalize the impact of these rules in several respects. For example, under old law, it was not uncommon for plans to give the employer discretion to accept or reject a participant's election with regard to the payout of deferred amounts, e.g., discretion to reject a lump sum election. Although the Notice, on the whole, treats the employer's exercise of discretion under a plan as being sufficient to trigger a material modification, it excepts from the scope of this rule the employer's exercise of discretion over the time and manner of payment of a benefit to the extent the plan provided for such discretion on October 3, 2004. It is not clear whether this exception would extend to situations in which the discretion is exercised by a third party, e.g., a plan administrator, although perhaps it may be argued that such action is not a material modification in the first instance, or to the extent it represents an exercise of discretion on behalf of the employer, is covered by the above exception. Prior to the issuance of the Notice, it had been unclear whether an employer that wanted to end its deferred compensation plan as a result of the new legislation could terminate it and pay out the

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Effective Date and Transition Relief (cont'd)	participants prior to December 31, 2005 is not a material modification, but deferred amounts must be included in income at the time of termination. Until December 31, 2005, a stock option or SAR that provides for a deferral of compensation may be cancelled and replaced with a "plain vanilla" stock option or SAR that does not constitute deferred compensation under section 409A without causing a material modification. *See* Q&A 18(c) and (d). Conforming plan terms and operation to section 409A. Although the Notice does not provide guidance on several issues arising from section 409A, plans adopted prior to December 31, 2005 will be considered compliant with the restrictions on distributions, accelerations and elections if (1) taxpayers operate such plans in good faith compliance with section 409A and the Notice, and (2) taxpayers amend the plans on or before December 31, 2005 in order to conform to section 409A with respect to deferred amounts that are subject to section 409A. A plan may be operated in good faith even if one plan participant exercises a right that causes the plan not to satisfy the requirements of section 409A with respect to that participant. Q&A 19(a) and (b). Transition rule for participant opt-out elections. A plan adopted prior to December 31, 2005 that is amended to allow termination of participation or cancellation of a deferral election will not violate with the restrictions on distributions, accelerations and elections of section 409A if (1) the amendment is made prior to December 31, 2005, and (2) amounts subject to termination or cancellation are includable in income when earned and vested. Q&A 20. Transition rule for distribution elections. A plan may also be amended to provide for new payment elections (or in the case of a stock option or SAR to provide for a fixed payment date) with respect to amounts deferred prior to the election, provided that the participant makes the election prior to December 31, 2005. Q&A 19(c). Severance plans are not required to satisfy the requirements of section 409A in 2005 with regard to severance benefits if they are collectively bargained or if they do not cover key employees. Q&A 19(d). Transition rule for initial elections. Section 409A requires that initial deferral elections be made before the tax year in which the services giving rise to the compensation are performed and that performance-based compensation elections be made at least six months before the end of the performance period. For services	deferrals without the payout being subject to section 409A (including the 20% penalty). The Notice provides transition relief for such employers. Many deferred compensation excess plans are keyed to the terms of a qualified plan. The Notice does not directly answer the question whether an amendment to the qualified plan will trigger a material modification to the excess plan in such circumstances. The Notice is not clear, given the definition of a plan, what the consequences are of a material modification to a plan affecting only some, but not all, participants – e.g., one person's pre-2005 deferrals are vested prior to January 1, 2005. Presumably, because of the one person-one plan rule, the modification would only affect that person's plan, and not the other participants. *Caution*: The Notice requires plan sponsors to operate the plan during the transition period in good-faith compliance with the new rules of section 409A. As previously noted, while plan sponsors can delay the adoption of plan amendments and the soliciting of participant elections under the relief provided in the Notice, plan sponsors must begin to comply operationally with the new rules, e.g., with regard to distributions to key employees on separation from service, effective January 1, 2005. Q&A 19(c) of the Notice permits payout elections to be reformed if they are made before the end of 2005. Presumably this provision will also legitimize payout elections made in 2004 for distributions in 2005 under the terms of the old plan where the elections are not made in sufficient time to meet the timing requirements for second elections under section 409A. Other than the limited transition exception for severance benefits in 2005 under certain rank-and-file type plans and collectively bargained plans, the Notice does not directly address the status of severance plans. As noted above, though, if a participant does not have a legally binding right to severance before it is awarded and the award is paid in a lump sum, the benefit may be exempt under the exception for short-term deferrals in the definition of deferred compensation adopted by the Notice.
Effective Date and Transition Relief (cont'd)		Treasury has provided relief from the timing rule for initial deferral elections for deferrals that are subject to section 409A, provided the initial deferral election is made before March 15, 2005. This relief will, for example, allow late initial deferral elections for

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Effective Date and Transition Relief (cont'd)	performed in 2005, however, these restrictions on the timing of elections will not apply to any elections made on or before March 15, 2005, provided that (1) the amounts to which the deferral election relates have not been paid or become payable at the time of the election, (2) the plan was in existence on or before December 31, 2004, (3) the elections are otherwise made in accordance with the terms of the plan in effect on or before December 31, 2005, (4) the plan is otherwise operated in accordance with section 409A, and (5) the plan is amended to comply with the requirements of section 409A by December 31, 2005. Q&A 21. Transition rule for initial elections for bonus compensation. The Notice states that Treasury and the IRS intend to issue guidance on what constitutes performance-based compensation for which elections may be made six months before the end of the performance period. Until this guidance is issued, however, certain bonus compensation is considered performance-based if (1) payment is "contingent on the satisfaction of organizational or individual performance criteria," and (2) "the performance criteria are not substantially certain to be met at the time a deferral election is permitted." If payment is conditioned solely on the value of, or appreciation in the value of, the employer or the employer's stock, the compensation is not considered performance-based. The Notice states that future Treasury guidance on performance-based compensation will set forth requirements that are anticipated to be more restrictive than this transitional guidance. Q&A 22. Temporary relief for distribution elections under mirror excess plans or SRPs. Until December 31, 2005, elections as to the timing and form of payment under a nonqualified deferred compensation plan may be controlled by a payment election made by the participant under a qualified plan, provided that the elections are made in accordance with the terms of the nonqualified deferred compensation plan as of October 3, 2004. Q&A 23.	annual bonus plans payable in 2005 with regard to 2004 that are not grandfathered, as well as initial deferral elections with regard to bonus plans that do not qualify for relief under the special rule for bonus compensation. It is important to note that while most employer actions may be delayed until the end of 2005, employers will need to act by March 15, 2005 to take advantage of this relief. The temporary rule for performance-based compensation makes it important to determine whether the performance is contingent on organizational or individual goals and whether the goal is not substantially certain to be met at the time of the election. Employers with concerns about meeting these standards should consider obtaining elections by March 15, 2005. It is not uncommon for mirror excess plans or SRPs to provide the same array of distribution options as the qualified plan but to allow the participant under the excess plan or SRP to make a separate distribution election as to such options. It appears that the such plans would not be eligible for the special relief granted by the Notice, although Q&A 19(c) would appear to allow late elections under such plans with regard to distributions elections.
Reporting and Withholding Requirements	Information reporting. New sections 6041(g)(1) and 6051(a)(13) generally require annual reporting of all compensation deferred under a nonqualified deferred compensation plan, regardless of whether such compensation is includable in gross income	Employers will want to consider how they are going to capture the information needed to report deferrals to their employees and independent contractors. For now, the exception for de minimis amounts is not very large, so the reporting burden could be

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Reporting and Withholding Requirements (cont'd)	pursuant to section 409A. Q&A 24. Employers and other payers should report the total amount of deferrals on Form W-2 or 1099-MISC, as the case may be. Q&A 29, 30. The rules for reporting deferred compensation in Box 11 of Form W-2 are not affected by the Notice. Q&A 29. The Notice does not provide guidance on how to calculate the amount of deferrals for the year. Q&A 25. Information reporting is required for amounts deferred under nonaccount balance plans, unless the amounts deferred are not "reasonably ascertainable," (within the meaning of the rules under section 3121(v)(2)). Q&A 26. Until more detailed guidance is published, information reporting will not be required under section 6051(a)(13) for deferrals that do not exceed $600 for an individual employee. Q&A 27. These information reporting requirements are effective for amounts "actually deferred" in calendar years beginning after December 31, 2004, and to income attributable to such amounts. For this purpose, amounts are actually deferred at the time that the participant has a legally binding right to the compensation. Therefore, the information reporting requirements are not applicable to amounts actually deferred prior to January 1, 2005, even if section 409A is otherwise applicable to such amounts because, e.g., the amounts are not earned and vested as of December 31, 2004. Q&A 28. Wage withholding. Any amount that is includable in the gross income of an employee under section 409A is treated as a payment of wages for purposes of section 3401(a). The Notice does not provide guidance, however, on how to compute the amount includable in gross income of an employee. Q&A 31. For the calendar year 2005, amounts includable in gross income under section 409A that have not been actually or constructively received by an employee may be treated as having been paid for income tax withholding purposes on any date on or before December 31, 2005. Q&A 32. These amounts should be reported on Form W-2. Q&A 33. Section 409A does not affect the imposition of the employee tax and the employer tax under FICA. Q&A 37. If an employer furnishes an expedited W-2 before the issuance of additional guidance on the computation of amounts includable in income, the employer may choose not to report the amount of deferrals, or the amount included in income. on the W-2, but must	extensive depending on the coverage of the employer's deferred compensation programs.

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	thereafter furnish a corrected W-2 if the subsequent guidance requires the employer to report the deferral or the amount included in income and wages. Q&A 38. A payer must report to a non-employee any amount includable in gross income under section 409A that is not treated as wages. Such reporting is not required, however, for persons with respect to whom a Form 1099-MISC is not required to be filed. *See* Q&A 34 and 35. Amounts includable in a self-employed individual's gross income under section 409A will generally be subject to self-employment taxes. Q&A 36.	